Contents

Questions within the Workbook should be treated as preparation questions, providing you with a firm foundation before you attempt the exam-standard questions. The exam-standard questions are found in the Question Bank.

Chapter 1

Ledger accounting and double entry

Introduction

Learning outcomes

- Identify the sources of information for the preparation of accounting records and financial statements
- Record and account for transactions and events resulting in income, expenses, assets, liabilities and equity in accordance with the appropriate basis of accounting and the laws, regulations and accounting standards applicable to the financial statements
- Prepare journals for nominal ledger entry and correct errors in draft financial statements

Specific syllabus learning outcomes are: 1c, d; 2c

Syllabus links

The material in this chapter will be developed further in this exam, and then in the Professional Level module *Financial Accounting and Reporting*.

Examination context

Questions on the topics in this chapter will be set as multiple choice questions, multi-part multiple choice or multiple-response questions, some of which may involve calculations so that the correct answer can be selected. Very often double entry questions are phrased in terms of preparing a journal entry.

In the exam you may be required to:

- identify the effect of debit and credit entries in ledger accounts for the elements of financial statements
- specify the double entry needed to record particular transactions
- identify entries in ledger accounts for VAT, payables and receivables

Chapter study guidance

Use this schedule and your study timetable to plan the dates on which you will complete your study of this chapter.

Topic	Practical significance	Study approach	Exam approach	Interactive Questions
1	**Ledgers** A ledger is simply the name given to the separate records in which transactions are recorded. It is a commonly used term in accountancy.	**Approach** Topic 1 is a short introduction to what is meant by the term ledger. Pay attention to the names for the key ledgers used. **Stop and think** Why might a business maintain a payables ledger and receivables ledger separate from the nominal ledger?	In the exam you may be required to identify the effect of debit and credit entries in ledger accounts for the different elements of financial statements. We will continue to work towards this as we progress through *Accounting*.	
2	**The nominal ledger**	**Approach**		

	The nominal ledger is the main record in which accounting transactions are recorded. It is important that you understand the format of a nominal ledger account.	You can cover this section quite quickly.	In the exam you may be required to identify the effect of debit and credit entries in ledger accounts for the elements of financial statements. The nominal ledger is central to this.	
3	**Double entry bookkeeping** Double entry bookkeeping is a key concept in accounting. All transactions entered into an accounting system, whether computerised or manual, must follow the principles of double entry. In double entry bookkeeping, all transactions undertaken by a business are captured in the accounting records by creating debit entries which must be matched by corresponding credit entries.	**Approach** Double entry bookkeeping is at the core of the *Accounting* syllabus. You may not instantly 'get' double entry. Try not to worry; take things slowly. You need to learn the rules of double entry in terms of what a debit entry and a credit entry can do to the elements of the financial statements. There are plenty of worked examples and interactive questions in this topic that you should cover thoroughly. **Stop and think** Consider the accounting equation. Why is it important to check the equation is still in balance after each transaction is recorded?	Double entry is central to *Accounting* and you will soon start to think in terms of debits and credits. In the exam you may be required to: • identify the effect of debit and credit entries in ledger accounts for the elements of financial statements; • specify the double entry needed to record particular transactions Double entry will also be essential in the long-form question.	**IQ1 Debits and credits I** This is an important question which covers the 'rules' of double entry bookkeeping. **IQ2 Debits and credits II** This question gives further practice of thinking of transactions in terms of debits and credits. **IQ3 Ledger accounts** This question provides good practise of preparing ledger accounts to record some common business transactions.
4	**Journal entries** Journal entries are simply a standard way of presenting the double entry required to record a transaction.	**Approach** Take your time to work through the worked example carefully. It is really just an extension of double entry. **Stop and think** Why is it good practice to include a description of each journal entry?	Very often double entry questions are phrased in terms of preparing a journal entry. You also need to be able to prepare journal entries for the long-form questions.	

5	**Double entry for petty cash** We covered petty cash in the previous chapter. Now we must apply the rules of double entry to record petty cash transactions in the financial statements.	**Approach** It is important to cover the worked examples carefully to understand where the totals of each column are posted.	In the exam, you may be required to specify the double entry needed to record particular transactions, which includes petty cash transactions.	
6	**The receivables and payables ledgers** The receivables ledger is a listing of all credit customer balances. The payables ledger is a list of all credit suppliers. It is important to maintain these lists for the purposes of credit control and making timely payments.	**Approach** Although this is a short narrative topic, it contains important concepts that we will revisit later in *Accounting*. Ensure you understand that these are memorandum accounts only. **Stop and think** Why would a business want to maintain a list of all amounts owed by its credit customers?	In the exam you may be required to identify entries in ledger accounts for payables and receivables. We will also later meet reconciliations which also use the receivables and payables ledgers.	
7	**Accounting for discounts** Accurate recording of sale and purchase transactions requires us to record discounts offered by sellers to their customers. You must understand that trade discounts are recorded differently from early settlement discounts.	**Approach** There is a lot to understand in this topic. Start with trade discounts, which is simpler. You might find accounting for settlement discounts more difficult. Work through the different scenarios in the worked examples carefully. **Stop and think** Why would a business offer a 5% early settlement discount to a customer?	In the exam, you will be expected to accurate record trade and early settlement discounts using double entry and demonstrate that you understand how they impact trade receivables and trade payables balances.	**IQ5 Discounts I** This question requires the calculation of trade and early settlement discounts. **IQ6 Discounts II** This question tests you understand how discounts are reflected in the statement of profit or loss. It is important to cover both of these questions to aid your

				understanding of discounts.
8	**Accounting for VAT** VAT is an indirect tax on the supply of goods and services. It is not income nor an expense of a VAT-registered business. VAT is separately accounted for in order that it can be recorded for HMRC.	**Approach** You need to understand how to calculate VAT (from net and gross amounts) and how to account for it. If you try to remember that it is not income or an expense of a VAT-registered business, this should help with the accounting. **Stop and think** If a business collects VAT on its sales, why should it not be recorded in income?	In the exam you may be required to identify entries in ledger accounts for VAT. This may mean you need to record transactions that include VAT, or calculate the balance on the VAT account.	**IQ7 VAT** This is a good test of your knowledge of how to calculate VAT when given the information in different forms.

Once you have worked through this guidance you are ready to attempt the further question practice included at the end of this chapter.

1 Ledgers

Section overview

- The nominal ledger, receivables ledger and payables ledger are the main ledgers used in an accounting system.
- Records should be kept in ledgers in chronological order, with cumulative totals built up.

2.1 Use of ledgers

A business continually enters into transactions such as buying and selling goods, paying credit suppliers and collecting cash from credit customers. To prepare financial statements on the completion of every individual transaction would be a time consuming and cumbersome administrative task.

Instead we use **ledgers** to record and **analyse** the transactions undertaken. When the time comes to prepare the financial statements, the relevant information can be extracted easily from the ledgers.

'Ledger' is a historical term which simply means 'book'. Traditionally, in a manual system of accounting, the business's transactions were recorded in three main books – the **nominal ledger,** the **receivables ledger** and the **payables ledger**. The nominal ledger contained a **separate ledger account** (usually a page of the book) for each type of income, expense, asset and liability and for capital. The **receivables ledger** contained a separate ledger account for each **credit customer** and the **payables ledger** contained a separate ledger account for each **credit supplier**. We still use this terminology in a computerised accounting system because the underlying bookkeeping principles are the same. We will refer to the nominal ledger, the receivables ledger and the payables ledger throughout this Study Manual.

The transactions in ledger accounts should be recorded:

- In **chronological order** and **dated** so that transactions can be related to a particular period of time.
- Built up in **cumulative totals**.
  - Day by day (eg, total sales on Monday, total sales on Tuesday)
  - Week by week
  - Month by month
  - Year by year

3 The nominal ledger

Section overview

- The nominal ledger is the main accounting record in which financial transactions are recorded.
- The nominal ledger contains several ledger accounts that represent each of the categories of asset, liability, capital, income and expense of a business.
- A 'T-account' is one way of recording which ledger accounts are affected by transactions. In a T-account, the left hand side is the debit side, and the right hand side is the credit side.

4.1 What is the nominal ledger used for?

Definition

Nominal ledger: The main accounting record in which financial transactions are recorded.

The nominal ledger contains details of assets, liabilities, capital, income and expenditure, and therefore profit and loss. It consists of a large number of different **ledger accounts**, each account having its own purpose or 'name' and an identity or code.

In a computerised accounting system, each ledger account is assigned a unique code. The codes are normally assigned in such a way that related or similar ledger accounts will have consistent coding. For example, administrative expenses may have the code 100000, telephone expenses may be 100100, rent expenses 100200 etc. This means that the expense categories will appear sequentially when data is extracted from the accounting system (see Chapter 5).

Examples of ledger accounts in the nominal ledger include:

- plant and machinery at cost (non-current asset)
- motor vehicles at cost (non-current asset)
- plant and machinery, accumulated depreciation (deduction from non-current asset)
- motor vehicles, accumulated depreciation (deduction from non-current asset)
- owner's capital (capital)
- inventories – raw materials (current asset)
- inventories – finished goods (current asset)
- total trade receivables (current asset)
- total trade payables (current liability)
- wages and salaries (expense)
- rent and local taxes (expense)
- advertising expenses (expense)
- bank charges (expense)
- motor expenses (expense)
- telephone expenses (expense)
- sales (income)
- total cash/bank overdraft (current asset/liability)

A computerised accounting system will use the code assigned to each nominal ledger account to automatically classify each account into the elements of the financial statements. The income and expense ledger accounts will together form the statement of profit or loss, while the asset, capital and liability ledger accounts will together form the statement of financial position.

Professional skills focus: Assimilating and using information

The information included in the ledger accounts within the nominal ledger is the starting point to preparing the financial statements of a business. It is important that information is accurately recorded in the correct ledger accounts if the financial statements are to show a true and fair view.

4.2 The format of a ledger account

An accounting record captures more than the amount of the transaction. It will record the date, a brief description of the transaction and often a unique reference. Throughout *Accounting* and elsewhere in your ICAEW studies, we will use a T-account format to present the entry of a transaction into a ledger account.

ADVERTISING EXPENSES

Date	Narrative	Ref.	£	Date	Narrative	Ref.	£
20X6	JFK Agency for quarter to 31 March	PL 348	2,500				

There are two sides to the account, with an account heading on top. The lines form a 'T', so this is what we mean by **'T'-account**.

- On top of the account is its name.
- There is a left hand, or **debit** side.
- There is a right hand, or **credit** side.

NAME OF ACCOUNT

	£		£
Debit side		Credit side	

5 Double entry bookkeeping

Section overview

- The principle of double entry bookkeeping is that, for each transaction, every debit entry has an equal credit entry.
- Debit entries increase assets and expenses, and decrease liabilities, capital and income.
- Credit entries increase liabilities, capital and income, and decrease assets and expenses.
- A receipt of cash is a debit in the cash at bank account.
- A payment of cash is a credit in the cash at bank account.
- A credit sale is recorded as debit receivables (increase asset), credit sales (increase income).
- A credit purchase is recorded as debit purchases (increase expenses), credit payables (increase liabilities).

Definition

Double entry bookkeeping: Each transaction has an equal but opposite effect. Every accounting event must be entered in ledger accounts both as a debit and a credit.

6.1 Dual effect (duality concept)

Double entry bookkeeping is the method used to record transactions in the **nominal ledger accounts**.

Central to this process is the idea that every transaction has two effects, the **dual effect** (also known as the **duality concept**). This feature is not something peculiar to business. If you were to purchase a car for £1,000 cash, for instance, you would be affected in two ways:

- You own a car (an asset) worth £1,000.
- You have £1,000 less cash (an asset).

If instead you got a bank loan to make the purchase:

- You own a car (an asset) worth £1,000.
- You owe the bank £1,000 (a liability).

A month later if you pay a garage £50 to have the exhaust repaired:

- You have £50 less cash (an asset).
- You have incurred a repairs expense (an expense) of £50.

Ledger accounts, with their debit and credit sides, are kept in a way which allows the two-sided nature of every transaction to be recorded. This is known as **double entry bookkeeping**, because **every transaction is recorded twice in the ledger accounts**.

6.2 The rules of double entry bookkeeping

A **debit entry** will:

• increase an asset	• decrease a liability
• increase an expense	• decrease capital
	• decrease income

A **credit entry** will:

• decrease an asset	• increase a liability
• decrease an expense	• increase capital
	• increase income

The basic rule, which must always be observed, is that **every financial transaction gives rise to two accounting entries, one a debit and the other a credit**. The total value of debit entries in the nominal ledger is therefore always equal to the total value of credit entries. Which account receives the credit entry and which receives the debit entry depends on the nature of the transaction.

- An **increase** in an **expense** (eg, a purchase of stationery) or an **increase in an asset** (eg, a purchase of office furniture) is a **debit**.
- An **increase** in **income** (eg, a sale) or an **increase in a liability** (eg, buying goods on credit) or **capital** is a **credit**.
- A **decrease** in an **asset** (eg, making a cash payment) or a **decrease in an expense** is a **credit**.
- A **decrease** in a **liability** (eg, paying a credit supplier) or **capital** or **income** is a **debit**.

In terms of 'T' accounts, for assets, liabilities and capital:

ASSET

ASSET		**LIABILITY**		**CAPITAL**	
£	**£**	**£**	**£**	**£**	**£**
DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
Increase	Decrease	Decrease	Increase	Decrease	Increase

For income and expenses, think about profit. Profit retained in the business increases capital. Income increases profit and expenses decrease profit.

INCOME		**EXPENSE**	
£	**£**	**£**	**£**
DEBIT	CREDIT	DEBIT	CREDIT
Decrease	Increase	Increase	Decrease

Interactive question 1: Debits and credits I

Complete the following table relating to the transactions of a bookshop. (The first two are done for you.)

(1) **Purchase of books on credit**			
• Payables increase	CREDIT	payables	(increase in liability)
• Purchases increase	DEBIT	purchases	(increase in expense)
(1) **Purchase of cash register by cheque**			
• Own a cash register	DEBIT	non-current asset	(increase in asset)
• Cash at bank decreases	CREDIT	cash at bank	(decrease in asset)
(3) **Payment received from a credit customer**			
• Receivables decrease			
• Cash at bank account increases			
(1) **Sell books for cash**			
• Revenue increases			
• Cash at bank account increases			

See **Answer** at the end of this chapter.

6.3 Double entry for cash transactions

A good starting point is the cash at bank account in which receipts and payments of cash are recorded based on the transaction reports downloaded from the electronic banking system.

- A cash **payment** is a **credit** entry in the cash at bank account. Here **cash (an asset) is decreasing**. Cash may be paid out, for example to pay an expense (such as insurance) or to purchase an asset (such as a machine). The matching debit entry is therefore made in the appropriate expense or asset account.
- A cash **receipt** is a **debit** entry in the cash at bank account. Here **cash (an asset) is increasing**. Cash might be received, for example, by a retailer who makes a cash sale. The credit entry would then be made in the revenue (income) account (and the VAT account if relevant).

Worked example: Cash transactions

A business has the following transactions:

(1) Receive £250 in respect of a cash sale

(2) Pay a rent bill totalling £150

(3) Pay £100 cash for goods

(4) Pay £200 cash for shelves

Requirement

Record these transactions in the nominal ledger accounts. Remember each transaction will be posted twice, in accordance with double entry rules.

Solution

(1) The two sides of the transaction are:

- £250 cash is received (debit cash at bank account)
- sales increase by £250 (credit sales account)

CASH AT BANK ACCOUNT

	£		£
Sales a/c	250		

SALES ACCOUNT

	£		£
		Cash at bank a/c	250

The cash at bank account entry is cross referenced to the sales account and vice versa. This enables a person looking at one of the ledger accounts to trace where the other half of the double entry is found.

(2) The two sides of the transaction are:

- cash is paid (credit entry in the cash at bank account)
- rent expense increases by £150 (debit entry in the rent expense account)

CASH AT BANK ACCOUNT

	£		£
		Rent a/c	150

RENT ACCOUNT

	£		£
Cash at bank a/c	150		

(3) The two sides of the transaction are:

- cash is paid (credit entry in the cash at bank account)
- purchases increase by £100 (debit entry in the purchases expense account)

CASH AT BANK ACCOUNT

	£		£
		Purchases a/c	100

PURCHASES ACCOUNT

	£		£
Cash at bank a/c	100		

(4) The two sides of the transaction are:

- cash is paid (credit cash at bank account)
- assets – in this case, shelves – increase by £200 (debit fixtures and fittings account)

CASH AT BANK ACCOUNT

	£		£
		Fixtures and fittings a/c	200

FIXTURES AND FITTINGS ACCOUNT

	£		£
Cash at bank a/c	200		

After all of these transactions have been posted, the cash at bank account of that business would end up looking as follows.

CASH AT BANK ACCOUNT

	£		£
Sales a/c	250	Rent a/c	150
		Purchases a/c	100
		Fixtures and fittings a/c	200

6.4 Double entry for credit transactions

Not all transactions are settled immediately. A business can purchase goods or non-current assets on credit terms, so that balances owed to suppliers would be trade payables until settlement was made in cash at a later date. Equally, the business might grant credit terms to customers, so the balances owed by customers would then be trade receivables of the business.

No entries are made in the cash at bank account when a credit transaction occurs, because no cash has been received or paid. Instead we use **receivables and payables accounts**. When a business acquires goods or services on credit, the credit entry is posted to the 'trade payables' account instead of the cash account. The debit entry is posted to the expense or asset account, exactly as in the case of cash transactions. Similarly, when a sale is made to a credit customer, the entry is a debit to the trade receivables account (instead of cash account), and a credit to the sales account.

Worked example: Double entry for credit transactions

A business entered into the following transactions:

(1) The business sells goods on credit to Mr A for £2,000.

(2) The business buys goods on credit from B Ltd for £100.

Requirement

How and where are these transactions posted in the ledger accounts?

Solution

(1) TRADE RECEIVABLES

	£		£
Sales a/c	2,000		

SALES ACCOUNT

	£		£
		Trade receivables a/c	2,000

(2) TRADE PAYABLES

	£		£
		Purchases a/c	100

PURCHASES ACCOUNT

	£		£
Trade payables a/c	100		

6.4.1 Double entry when cash is paid by credit customers or to credit suppliers

What happens when a credit transaction is eventually settled in cash? Suppose that, in the example above, the business paid £100 to B Ltd one month after the goods were acquired. The two sides of this new transaction are:

- cash is paid (credit entry in the cash at bank account)
- the amount owing to trade payables is reduced (debit entry in the trade payables account)

CASH AT BANK ACCOUNT

	£		£
		Trade payables a/c	100

TRADE PAYABLES

	£		£
Cash at bank a/c	100		

If we now bring together the two parts of this example, the original purchase of goods on credit and the eventual settlement in cash, we find that the accounts appear as follows.

CASH AT BANK ACCOUNT

	£		£
		Trade payables a/c	100

PURCHASES ACCOUNT

	£		£
Trade payables a/c	100		

TRADE PAYABLES

	£		£
Cash at bank a/c	100	Purchases a/c	100

The two entries in trade payables cancel each other out, indicating that no money is owing to B Ltd. A cash account credit entry of £100 and a purchases account debit entry of £100 remain. These are the same as the entries used to record a **cash** purchase of £100. This is what we would expect: after the business has paid off its trade payables, it is in exactly the same position as if it had made a cash purchase, and the accounting records reflect this.

Similar reasoning applies when a customer settles a debt. In the example above, when Mr A pays his debt of £2,000 and it is recorded in the cash at bank account, the two sides of the transaction are:

(a) cash is received (debit entry in the cash at bank account)

(b) the amount owed by credit customers is reduced (credit entry in the trade receivables account)

CASH AT BANK ACCOUNT

	£		£
Trade receivables	2,000		

TRADE RECEIVABLES

	£		£
		Cash at bank a/c	2,000

The accounts recording the sale to, and payment by, Mr A now appear as follows.

CASH AT BANK ACCOUNT

	£		£
Trade receivables	2,000		

SALES ACCOUNT

	£		£
		Trade receivables a/c	2,000

TRADE RECEIVABLES

	£		£
Sales a/c	2,000	Cash at bank a/c	2,000

The two trade receivables entries cancel each other out, while the entries in the cash at bank account and sales account reflect the same position as if the sale had been made for cash (see above).

Interactive question 2: Debits and credits II

Identify the debit and credit entries in the following transactions (ignore VAT).

(1) Bought a machine on credit from A, cost £8,000

(2) Bought goods on credit from B, cost £500

(3) Sold goods on credit to C, value £1,200

(4) Paid D (a credit supplier) £300

(5) Collected £180 from E, a credit customer

(6) Paid net wages £4,000

(7) Received rent bill of £700 from landlord G

(8) Paid rent of £700 to landlord G

(9) Paid insurance premium £90

See **Answer** at the end of this chapter.

Interactive question 3: Ledger entries

Ron Knuckle set up a business selling fitness equipment. He put £7,000 of his own money into a business bank account (transaction A) and in his first period of trading, the following transactions occurred.

Transaction		£
B	Paid rent of shop for the period	3,500
C	Purchased equipment (inventories) on credit	5,000
D	Loan from bank	1,000
E	Purchase of shop fittings (for cash)	2,000
F	Sales of equipment: cash	10,000
G	Sales of equipment: on credit	2,500
H	Payments to credit suppliers	5,000
I	Receipts from credit customers	2,500
J	Interest on loan (paid)	100
K	Other expenses (all paid in cash)	1,900
L	Drawings	1,500

Ignore VAT.

Requirement

Prepare the ledger accounts for Ron Knuckle by opening up the following accounts and completing them:

• cash at bank account	• rent	• purchases
• capital	• shop fittings	• loan interest
• loan	• sales	• other expenses
• trade payables	• trade receivables	• drawings

See **Answer** at the end of this chapter.

7 Journal entries

Section overview

- Journal entries have a particular format that you should use.
- Journals can be used to record any type of financial transaction, but are mainly used to record transactions that are one-off or unusual in nature.

8.1 What are journal entries used for?

A journal entry is a way of presenting the required double entry (debits and credits) for a transaction. Any transaction can be represented by a journal entry. However, journal entries are generally used to record unusual or one off transactions, such as the correction of an error (covered in Chapter 6).

In the *Accounting* exam, you may be asked for the journal entry to record a particular transaction.

Whatever type of transaction is being recorded, the **format of a journal entry** is as follows:

Date	Debit	Credit
	£	£
Account to be debited	X	
Account to be credited		X

A **narrative explanation** should accompany each journal entry. It is required for audit and control, to indicate the purpose and authority of every transaction.

A computerised accounting system will not allow a journal entry to be processed if the debit entries do not equal the credit entries.

Worked example: Journal entries to record transactions

The following is a summary of the transactions of Hair by Fiona Middleton hairdressing business, of which Fiona is the sole owner.

1 January	Put in cash of £20,000 as capital Purchased fixtures and fittings for cash of £5,000 Purchased equipment on credit for £2,000
30 January	Paid three months rent to 31 March £1,500 Collected and paid in takings £600
31 January	Gave a regular customer a hair treatment for £80 on credit
31 January	Took out £100 for personal expenses

Requirement

Show the transactions by means of journal entries.

Solution

Journal

			£	£
1 January	DEBIT	Cash at bank account	20,000	
	CREDIT	Capital account		20,000
		Initial capital introduced		
1 January	DEBIT	Fixtures and fittings (non-current asset)	5,000	
	CREDIT	Cash at bank account		5,000
		The purchase for cash of fixtures and fittings		
1 January	DEBIT	Equipment (non-current asset)	2,000	
	CREDIT	Trade payables		2,000
		The purchase of equipment on credit		
30 January	DEBIT	Rent expense account	1,500	
	CREDIT	Cash at bank account		1,500
		The payment of rent to 31 March		

			£	£
30 January	DEBIT	Cash at bank account	600	
	CREDIT	Sales account		600
		Cash takings		
31 January	DEBIT	Trade receivables	80	
	CREDIT	Sales account		80
		The provision of hair treatment on credit		
31 January	DEBIT	Drawings	100	
	CREDIT	Cash at bank account		100
		Owner's drawings		

9 Double entry for petty cash

Section overview

- The double entry for transactions recorded in the petty cash book involves an entry to the petty cash account and the relevant expense category.

10.1 Double entry for petty cash transactions

In Chapter 3, we saw how the petty cash book is used to record petty cash transactions. It is now time to see how the **double entry** works.

A business starts with a cash float (imprest) on 1.3.20X7 of £250. This will be a payment from cash at bank to petty cash:

DEBIT	Petty cash	£250	
CREDIT	Cash at bank		£250

Suppose five payments were made out of petty cash during March 20X7, none of which attracted VAT. The petty cash book might look as follows:

Total receipts	Date	Narrative	Total payments	Postage	Travel
£			£	£	£
250.00	1.3.X7	Cash			
	2.3.X7	Stamps	12.00	12.00	
	8.3.X7	Stamps	10.00	10.00	
	19.3.X7	Travel	16.00		16.00

Total receipts	Date	Narrative	Total payments	Postage	Travel
£			£	£	£
	23.3.X7	Travel	5.00		5.00
	28.3.X7	Stamps	11.50	11.50	
250.00			54.50	33.50	21.00

At the end of each month (or at any other suitable interval) the total payments in the petty cash book are **posted to the appropriate nominal ledger accounts**. This just means that the totals of the columns are entered as debit and credit entries in the ledger accounts. For March 20X7, £33.50 would be **debited** to the postage account and £21.00 to the travel account. The total payments of £54.50 are **credited** to the petty cash account. The amounts are recorded using the following journal entry:

		£	£
DEBIT	Postage	33.50	
DEBIT	Travel	21.00	
CREDIT	Petty cash		54.50

Next, the cash float needs to be topped up to the imprest amount by a payment of £54.50 from the business bank account:

DEBIT

DEBIT	Petty cash	£54.50	
CREDIT	Cash at bank		£54.50

So double entry rules have been satisfied, and the petty cash book for the month of March 20X7 will look like this:

Receipts	Date	Narrative	Payments	Postage	Travel
£			£	£	£
250.00	1.3.X7	Cash			
	2.3.X7	Stamps	12.00	12.00	
	8.3.X7	Stamps	10.00	10.00	
	19.3.X7	Travel	16.00		16.00
	23.3.X7	Travel	5.00		5.00
	28.3.X7	Stamps	11.50	11.50	
	31.3.X7	Balance carried down (c/d)	195.50		
250.00			250.00	33.50	21.00
195.50	1.4.X7	Balance brought down (b/d)			
54.50	1.4.X7	Cash			

The cash float is back up to (£195.50 + £54.50) = £250 imprest on 1.4.X7, ready for more payments to be made.

The petty cash account in the nominal ledger will be as follows:

20X7

20X7		£	20X7		£
1.3	Cash	250.00	31.3	Payments	54.50
1.4	Cash	54.50	1.4	Balance c/d	250.00
		304.50			304.50
1.4	Balance b/d	250.00			

Interactive question 4: Petty cash

Summit Glazing operates an imprest petty cash system. The imprest amount is £150.00. At the end of the period the totals of the expense columns in the petty cash book were as follows:

	£
Stationery	23.12
Sundries	6.74
Postage	12.90
Travel	28.50

Requirement

How much cash is required to restore the imprest amount?

See **Answer** at the end of this chapter.

11 The receivables and payables ledgers

Section overview

- The receivables ledger is where the individual ledger accounts for each credit customer (personal accounts) are maintained.
- A total receivables account is held in the nominal ledger, called trade receivables.
- The payables ledger is where the individual ledger accounts for each credit supplier (personal accounts) are maintained.
- A total payables account is held in the nominal ledger, called trade payables.

12.1 Nominal ledger accounts and personal accounts

Nominal ledger accounts relate to types of income, expense, asset, capital and liability – rent, sales, trade receivables, payables and so on – but do not record individual details relating to the person to whom the money is paid or from whom it is received. However, there is also a need for **personal** accounts, most commonly for receivables and payables, and these are contained in the **receivables ledger** and the **payables ledger**. These are **memorandum accounts** only, in memorandum ledgers; they are **not** part of the double entry system. Instead **trade receivables** and **trade payables** accounts are kept in the nominal ledger which record the totals of the receivables and payables ledgers.

In a manual system of accounting, the receivables and payables ledgers would be updated separately from the nominal ledger. It was therefore possible that, due to errors, there would be differences between balances in the receivables and payables ledgers and the totals in the nominal ledger.

In a computerised accounting system, sales and purchase invoices, credit notes and payments are recorded in the receivables and payables ledgers which will then automatically update trade receivables and trade payables in the nominal ledger. The total of the individual accounts in the receivables ledger at any point in time will be **exactly equal** to the total included in trade receivables, and the same will apply to the individual accounts in the payables ledger and trade payables.

Professional skills focus: Assimilating and using information

The receivables and payables ledgers are a key source of information for the purpose of understanding who an entity's receivables and payables are and what the balance owed from and to them is. It is important for you to understand that whilst these accounts hold important accounting information, these are **not** part of the nominal ledger system.

12.2 Receivables ledger

A business must also keep a record of how much money each **individual credit customer** owes, and what this total debt consists of. The need for a **personal account for each customer** is a practical one.

- A customer might ask how much they currently owe. Staff must be able to tell them.
- It is a common practice to send out **statements** to credit customers at the end of each month, showing how much they owe, and itemising new invoices or credit notes sent out and payments received during the month.
- The business managers will want to check the **credit position** of individual customers, and to ensure that no customer is exceeding their credit limit.

12.3 Payables ledger

The payables ledger, like the receivables ledger, consists of a number of personal accounts. These are separate accounts for **each individual supplier**, and they enable a business to keep a continuous record of how much it owes each supplier at any time. As we will see in Chapter 6, businesses regularly receive statements from their suppliers which show how much is owed at a point in time.

13 Accounting for discounts

Section overview

- A trade discount is a percentage discount deducted from the list price of goods, owing to the nature of the trading transaction.
- An early settlement discount is a discount offered to credit customers/offered by credit suppliers which can be taken if an invoice is paid within a required timeframe.
- Sales are recorded net of trade discounts and, if they are taken, net of early settlement discounts.
- Similarly, purchases are recorded net of trade discounts, and if they are taken, net of early settlement discounts.

There are two types of discount: trade discounts and early settlement discounts.

14.1 Trade discount

Definition

Trade discount: A percentage discount deducted from the list price of goods owing to the nature of the trading transaction.

A trade discount is a reduction in the amount of money initially demanded on an invoice.

- If a trade discount is received by a business for goods purchased from a supplier, the amount of money demanded from the business by the supplier will be net of discount (ie, it will be the list price less the discount).
- If a trade discount is given by a business for goods sold to a customer, the amount of money demanded of the customer by the business will be after deduction of the discount.

14.1.1 Examples of trade discount

- A customer is quoted a price of £1 per unit for a particular item, but a lower price of 95p per unit if the item is bought in quantities of 100 units or more at a time. This is sometimes called **bulk discount**.
- An important customer or a regular customer is offered a discount on all the goods they buy, regardless of the size of each individual order, because the total volume of their purchases over time is so large.

14.1.2 Accounting for trade discounts

- **Purchases** should be recorded **net of trade discounts** received from suppliers.
- **Sales** should be recorded **net of trade discounts** given to customers.

Trade discounts should be deducted before any early settlement discount is calculated.

14.2 Early settlement discounts

Businesses often offer discounts to credit customers to encourage them to settle amounts owed more quickly. These are known as early settlement discounts, prompt payment discounts or sometimes cash discounts.

Definition

Early settlement discount: A percentage reduction in the amount payable in return for payment within an agreed period.

A customer can choose whether or not to take an early settlement discount offered by a supplier. If the customer decides to take the early settlement discount, the amount they must pay is reduced, provided they pay within the required timeframe. If the customer decides not to take the discount, they must pay the full amount of the invoice but will have a longer period in which to pay.

For example, a supplier charges £1,000 for goods with a normal credit period of 30 days, but offers a discount of 5% if the goods are paid for within 10 days of the invoice date. If the customer decides to take the discount, they must pay £950 (£1,000 × 95%) within 10 days of the invoice date. If the customer decides not to take the discount, they must pay the full £1,000, but have 30 days in which to make the payment.

14.2.1 Accounting for early settlement discounts offered to customers

Sales should be recorded net of early settlement discounts taken by customers. However, at the point of invoice, when the sale is recorded in the accounting system, the business does not know whether or not the customer will take the early settlement discount offered. Therefore, when the sale is recorded, the business should determine whether they expect the customer to take the discount or not based on their knowledge of the customer and whether the customer has previously taken advantage of such discounts, and record the sale accordingly.

If, when payment is made, the customer does not behave as expected, eg, does take a discount when they were not expected to, the accounting records are adjusted to reflect the full gross value of the goods sold.

Determining whether a credit customer will or will not take advantage of an early settlement discount is matter of judgment for accountants in practice. In an exam question, that judgement will already have been made. You just need to know how to apply the correct accounting treatment.

Worked example: Early settlement discounts – credit sales

Finnie has normal credit terms of 30 days but offers a prompt payment discount of 5% to customers if they settle invoices within 10 days. On 19 April, Finnie sold goods totalling £500 to Ruby. Ruby normally takes advantage of the prompt payment discount offered. On 22 April, Finnie sold goods to Sarah totalling £340. Sarah normally takes a full 30 days to settle her invoices.

Requirement

Record the transactions in the ledger accounts of Finnie assuming that:

- Ruby pays within 10 days as expected
- Ruby pays in more than 10 days
- Sarah pays after 30 days as expected
- Sarah pays within 10 days

Solution

Accounting for the transaction with Ruby:

At the point of invoice

Finnie expects Ruby to take advantage of the prompt payment discount as she usually does so. Therefore the sale should be recorded net of the prompt payment discount: £500 × 95% = £475.

The journal entry to record the sale is:

DEBIT	Trade receivables	£475
CREDIT	Revenue	£475

The transaction is recorded in Finnie's ledger accounts as follows

TRADE RECEIVABLES

	£		£
Revenue	475		

REVENUE

	£		£
		Trade receivables	475

Ruby pays within 10 days as expected

If Ruby does pay within the 10 day period and secures the prompt payment discount as expected, at the point of payment, Finnie will record:

DEBIT	Cash at bank account	£475
CREDIT	Trade receivables	£475

TRADE RECEIVABLES

	£		£
Revenue	475	Cash at bank account	475

CASH AT BANK ACCOUNT

	£		£
Trade receivables	475		

Ruby does not pay within 10 days

However, if Ruby does not pay within 10 days and therefore does not take advantage of the prompt payment discount offered, she will be required to pay the full £500. An adjustment to revenue is therefore required to increase it to the full value of the sale. The journal entry to record the payment and the adjustment is:

DEBIT	Cash at bank account	£500
CREDIT	Trade receivables	£475
CREDIT	Revenue	£25

TRADE RECEIVABLES

	£		£
Revenue	475	Cash at bank account	475

CASH AT BANK ACCOUNT

	£		£
Trade receivables	475		
Sales	25		

REVENUE

	£		£
		Trade receivables	475
		Cash at bank account	25

Accounting for the transaction with Sarah

Based on experience of past transactions with Sarah, Finnie does not expect Sarah to take advantage of the prompt payment discount. When the invoice to Sarah is recorded, the discount should not be deducted and the full amount of the sale of £340 should be recorded in revenue and trade receivables.

TRADE RECEIVABLES

	£		£
Revenue	340		

REVENUE

	£		£
		Trade receivables	340

Sarah pays after 30 days as expected

If Sarah pays £340 after 30 days, as expected, the amount paid is recorded as per any other receipt from a credit customer and no other entries are necessary:

TRADE RECEIVABLES

	£		£
Revenue	340	Cash at bank account	340

CASH AT BANK ACCOUNT

	£		£
Trade receivables	340		

Sarah pays within 10 days

If Sarah unexpectedly pays within 10 days and secures the prompt payment discount, Sarah will only pay £323 (£340 × 95%). An adjustment to revenue and trade receivables is required to reduce the revenue recorded by the amount of the discount (5% × £340 = £17). The journal entry would be:

DEBIT	Cash at bank account	£323
DEBIT	Revenue	£17
CREDIT	Trade receivables	£340

TRADE RECEIVABLES

	£		£
Revenue	340	Cash at bank account	323
		Revenue	17

CASH AT BANK ACCOUNT

	£		£
Trade receivables	323		

REVENUE

	£		£
Trade receivables	17	Trade receivables	340

14.2.2 Accounting for early settlement discounts received from suppliers

Accounting for early settlement discounts offered to a business by its suppliers is consistent with the approach described above. Any early settlement discount received is offset against purchases or other appropriate expense category. A judgement should be made when the invoice is recorded as to whether or not the business is likely to take advantage of the early settlement discount offered.

Worked example: Early settlement discounts – credit purchases

Continuing the above example, prepare Ruby's ledger accounts to show how Ruby would record the purchase transaction assuming that she expected to take advantage of the early settlement discount but then did not pay within 10 days.

Solution

As Ruby expected to take advantage of the discount when the invoice was received, she should record the purchase net of the discount:

PURCHASES

	£		£
Trade payables	475		

TRADE PAYABLES

	£		£
		Purchases	475

As Ruby does not pay within the required 10 days, she must pay the full amount of the invoice of £500 as she will not be eligible for the prompt payment discount. Ruby must make an adjustment to purchases of £25 when the payment is made.

PURCHASES

	£		£
Trade payables	475		
Cash at bank account	25		

TRADE PAYABLES

	£		£
Cash at bank account	475	Purchases	475

CASH AT BANK ACCOUNT

	£		£
		Trade payables	475
		Purchases	25

14.2.3 Summary of accounting treatment for early settlement discounts

	Discounts offered to customers	Discounts received from suppliers
Discount is expected to be taken	Deduct the amount of the discount when recording the revenue and receivable. If payment is not received within agreed terms and discount is not taken, increase revenue by the amount of the discount.	Deduct the amount of the discount when recording the expense and payable. If payment is not made within agreed terms and discount is not received, increase the expense by the amount of the discount.
Discount is not expected to be taken	Do not deduct the amount of the discount when recording the revenue and receivable If the discount is unexpectedly taken, reduce the revenue and receivable accordingly.	Do not deduct the discount when recording the expense and payable. If the discount is unexpectedly taken, reduce the expense and payable accordingly.

Trade discounts should be deducted before any cash discount is calculated.

Interactive question 5: Discounts I

Soft Supplies Co recently purchased from Hard Imports Co 10 printers originally priced at £200 each. A 10% trade discount was negotiated together with a 5% early settlement discount if payment is made within 14 days. It is expected that advantage of the early settlement discount will be taken.

Requirements

5.1 The total of the trade discount.

5.2 The total of the early settlement discount.

See **Answer** at the end of this chapter.

Interactive question 6: Discounts II

You are required to prepare the statement of profit or loss of Seesaw Timber Merchants for the year ended 31 March 20X6, given the following information.

	£
Purchases at gross cost	120,000
Trade discounts received	4,000
Cash discounts received from suppliers	1,500
Cash sales	34,000
Credit sales at invoice price	150,000
Cash discounts provided to and taken by customers	8,000
Distribution costs	32,000
Administrative expenses	40,000

You should ignore VAT.

See **Answer** at the end of this chapter.

15 Accounting for VAT

Section overview

- Standing data in computerised accounting systems will include a business' VAT registration number and applicable VAT rates. This information is used to automatically calculate and record VAT on invoices. A computerised accounting system will also support accurate record keeping for VAT purposes.
- VAT on sales (output VAT) is debited to receivables and credited to the VAT control account (it is owed to HMRC).
- VAT on purchases (input VAT) is debited to the VAT control account (it is due from HMRC) and credited to payables.
- The net amount of VAT owed to HMRC is paid to HMRC regularly.

16.1 What is VAT?

Value added tax (VAT) is an indirect tax on the supply of goods and services. Tax is collected at each transfer point in the chain from prime producer to final consumer. Eventually, the consumer bears the tax in full and any tax paid earlier in the chain can be recovered by a registered trader who paid it.

Worked example: VAT

A manufacturing company, Alice Ltd, purchases raw materials at a cost of £1,000 plus VAT at the standard rate of 20%. From the raw materials Alice Ltd makes finished products which it sells to a retail outlet, Beach plc, for £1,600 plus VAT at 20%. Beach plc sells the products to customers at a total price of £2,000 plus VAT at 20%.

Requirement

How much VAT is paid at each stage in the chain?

Solution

	Value of goods sold	VAT 20%
	£	£
Supply to Alice Ltd (Alice Ltd pays £200 VAT but recovers it)	1,000	200
Value added by Alice Ltd	600	
Sale to Beach plc (Beach plc pays £320 VAT but recovers it)	1,600	320
Value added by Beach plc	400	
Sale to 'consumers' (customers pay £400 VAT, and cannot recover it)	2,000	400

16.2 How is VAT collected?

Although it is the final consumer who eventually bears the full VAT of £400, the sum is **collected and paid by the traders who make up the chain**, provided they are registered for VAT. Each trader must assume that his customer is the final consumer:

- He must collect and pay over VAT at the appropriate rate on the full sales value (known as **output tax**) of the goods sold.
- He is normally entitled to reclaim VAT paid on his own purchases of goods, expenses and non-current assets (known as **input tax**) and so makes a net payment to the HMRC equal to the tax on value added by himself.

In the example above, the supplier of raw materials collects from Alice Ltd output VAT of £200, all of which he pays over to HMRC. When Alice Ltd sells goods to Beach plc, output VAT is charged at the rate of 20% on £1,600 = £320. Only £120, however, is paid by Alice Ltd to HMRC, because the company is entitled to deduct input tax of £200 suffered on its own purchases. Similarly, Beach plc must charge its customers £400 in output VAT, but need only pay over to HMRC the net amount of £80 after deducting the £320 input VAT suffered on its purchase from Alice Ltd

16.3 Registered and non-registered traders

Traders whose sales (outputs) are below a certain level need not register for VAT although they may do so voluntarily. Unregistered traders neither charge VAT on their outputs nor are entitled to reclaim VAT on their inputs. They are in the same position as a final consumer.

All outputs of registered traders are either taxable or exempt. Traders carrying on **exempt activities** (such as banks) cannot charge VAT on their outputs and consequently cannot reclaim VAT paid on their inputs.

Taxable outputs are chargeable at one of **three rates**:

- **zero rate** (on printed books and newspapers for instance)
- **reduced rate** (5% on domestic fuel)
- **standard rate**: 20%

HMRC identifies supplies falling into each category. **Persons carrying on taxable activities** (even activities taxable at zero rate) **are entitled to reclaim VAT paid on their inputs**.

Some traders carry on a **mixture of taxable and exempt activities**. Such traders need to apportion the VAT suffered on inputs and **can usually only reclaim the proportion of input tax that relates to taxable outputs**.

The frequency with which businesses prepare a VAT return and make payments to HMRC depends on the amount of the taxable sales of the business, alongside other conditions such as the type of business, the history of preparing VAT returns on time and the history of making payments on time. The different VAT schemes in the UK is outside the scope of the *Accounting* course.

- The most usual position is to have to pay the net balance to HMRC (when output tax exceeds input tax) ie, the amount owed to HMRC is a payable.

- A trader who makes zero-rated supplies will have paid more input tax than it has received output tax, so will recover cash from HMRC, ie, the amount due from HMRC is a receivable.

16.4 Accounting for VAT

As a general principle the treatment of VAT in the trader's ledger accounts should reflect the trader's role as tax collector, so **VAT should not be included in income or in expenses, whether of a capital or a revenue nature**.

Professional skills focus: Structuring problems and solutions

You may be faced with a question in which VAT charged in a sales transaction or incurred in a purchase transaction has been recorded in income or expenses in error. You need to be able to calculate the VAT element of the transaction and correct the error.

16.4.1 Irrecoverable VAT

Where the **trader suffers irrecoverable VAT** as a cost, as in the following cases, VAT should be included as an expense (it cannot be claimed as input tax.)

- **Traders not registered** for VAT will suffer VAT on inputs as a cost. This will increase their expenses and the cost of any non-current assets they purchase.
- **Registered traders** who also carry on **exempted activities** may suffer VAT on certain inputs. This will increase the expense in respect of these inputs.
- **Non-deductible inputs will be borne** by all traders.
  - VAT on **cars** purchased and used in the business is not reclaimable (VAT on a car acquired new for resale, ie, by a car trader, is reclaimable).
  - VAT on **business entertaining** is not deductible as input tax other than VAT on entertaining staff.

Where VAT is not recoverable it must be regarded as part of the cost of the items purchased and included in the statement of profit or loss or statement of financial position as appropriate.

16.5 VAT and discounts

If a trade discount is given, VAT is charged on the sale amount net of the trade discount. If an early settlement discount is offered at the point of sale, **output VAT is accounted for on the amount that is actually received from the customer**. As a result, customers can recover VAT only on the actual amount paid to the supplier.

There are two options for a business when preparing an invoice that includes discounts and VAT:

- The supplier issues an invoice with VAT calculated on the sale price ignoring any offered early settlement discount, and records it in the normal way. If the customer takes up the early settlement discount, the supplier will issue a credit note for the amount of the discount, including the VAT on this.
- Alternatively, if the supplier does not wish to issue credit notes for this type of transaction, it must issue an invoice which states the full value of the transaction, including any VAT and a footnote which details the terms of the early settlement discount, and a statement that the customer can only recover as input tax the VAT paid to the supplier.

We will assume throughout the Study Manual that businesses will not issue credit notes when discounts are taken and will therefore adopt option (ii) above.

16.6 VAT and irrecoverable debts

Most registered persons are obliged to record VAT when a supply is made or received (effectively when a sales invoice is raised or a purchase invoice recorded). This may have the effect that **output tax has to be paid to HMRC before it has all been received from customers**. If an amount due from a customer is subsequently written off as irrecoverable, the VAT element may not be recoverable from HMRC for some time after the sale.

16.7 Summary of accounting entries for VAT

Let us summarise how VAT is recorded in the nominal ledgers accounts:

(a) **Sales** shown in the statement of profit or loss must **exclude output VAT**. However, trade receivables will **include** VAT, as they reflect the total amount due from customers.

The double entry for sales on credit of £500,000, excluding VAT at 20%, is:

		£	£
DEBIT	Trade receivables (including VAT, called **gross**)	600,000	
CREDIT	Revenue (excluding VAT, called **net**)		500,000
	VAT (20% × £500,000) – output tax		100,000

(b) **Expenses** shown in the statement of profit or loss must **exclude input VAT**. However, trade payables will **include** input VAT, as they reflect the total amount payable to suppliers. The double entry for credit purchases of £400, excluding VAT at 20%, is:

		£	£
DEBIT	Purchases expense (net)	400	
	VAT a/c (20% × £400) – input tax	80	
CREDIT	Trade payables (gross)		480

(c) Sales revenue received and expenses paid as cash transactions must also have the VAT recorded and posted as above in (a) and (b).

(d) **Irrecoverable VAT** on expenses or non-current assets must be **included in the cost** of the expense or non-current asset in the statement of profit or loss or statement of financial position.

(e) The net amount due to (or from) HMRC should be included in **other payables** (or **other receivables**) in the statement of financial position.

Professional skills focus: Structuring problems and solutions

Output VAT and input VAT as shown in the nominal ledger will form the basis of the VAT return provided to HMRC. Although you do not need to know about the VAT return in *Accounting*, you should be aware that it requires the accountant to compile and report specific information to the tax authorities.

16.8 Calculating VAT from a gross amount

If you are told that an amount **includes VAT** at 20% (a gross amount), you can calculate the VAT element by multiplying the gross amount by 20%/120% or 1/6. Therefore the net amount will always be 5/6 of the gross amount.

Context example: VAT calculation

A sale of £200 attracts VAT at 20%, ie, £40. The gross amount is £240. To get back to the VAT element:

£240 × 1/6 = £40

Interactive question 7: VAT

Mussel is preparing financial statements for the year ended 31 May 20X9. Included in its statement of financial position as at 31 May 20X8 was a balance for VAT due from HMRC of £15,000.

Mussel's summary statement of profit or loss for the year to 31 May 20X9 is as follows:

	£'000
Sales (net) (all standard rated)	500
Purchases (net) (all standard rated)	(120)
Gross profit	380
Expenses (see note)	(280)
Net profit	100

	£'000
Note: Expenses	
Wages and salaries (exempt of VAT)	162
Entertainment expenditure (£40 + irrecoverable VAT £8)	48
Other (net) (all standard rated at 20%)	70
	280

VAT payments of £5,000, £15,000 and £20,000 have been made in the year to HMRC and a repayment of £12,000 was received.

Requirement

What is the balance for VAT in the statement of financial position as at 31 May 20X9? Assume a 20% standard rate of VAT. (**Hint:** Use a T account for VAT.)

See **Answer** at the end of this chapter.

Summary

!! Error resolving referred content !!

Further question practice

1 Knowledge diagnostic

Before you move on to question practice, complete the following knowledge diagnostic and check you are able to confirm you possess the following essential learning from this chapter. If not, you are advised to revisit the relevant learning from the topic indicated.

Confirm your learning	
1	What is the nominal ledger? (Topic 2)
2	What can a debit entry do in terms of the elements of the financial statements? (Topic 3)
3	What can a credit entry do in terms of the elements of the financial statements? (Topic 3)
4	What is the difference between a trade discount and an early settlement discount? (Topic 7)
5	Where is output VAT recorded in the nominal ledger of a VAT-registered entity? (Topic 8)

2 Chapter self-test question practice

Aim to complete all the self-test questions at the end of this chapter. Once completed, attempt all the questions in the Ledger accounting and double entry chapter of the Accounting Question Bank. Refer back to the learning in this chapter for any questions which you did not answer correctly or where the suggested solution has not provided sufficient explanation to answer all your queries. Once you have attempted these questions, you can move on to the next chapter.

Self-test questions

Answer the following questions.

- The credit side of a journal entry may:

  A Increase sales

  B Increase expenses

  C Decrease trade payables

  D Increase trade receivables

. nominal ledger:

  A Is the record of all transactions not directly recorded by the computerised accounting system

  B Is used to record only transactions relating to receivables

  C Is used to record only transactions relating to payables

  D Is the record of an entity's financial transactions

. T account a debit entry would be made in the:

  A Left hand side

  B Right hand side

. A debit entry in a T account will:

  A Decrease an asset

  Decrease an expense

  C Increase a liability

  D Decrease capital

. edit entry in a T account will:

  A Decrease an asset

  B Increase an expense

  C Decrease a liability

  D Decrease capital

. n a credit customer pays an invoice for £120 including VAT at 20%, the credit entry in the VAT ledger account will be:

  A £120

  B £100

  C £20

  D Nil

. Early settlement discounts received from suppliers will:

  A Decrease purchases

  B Decrease sales

  C Increase trade payables

  D Increase trade receivables

. urnal entry does not need to contain:

  A The name of the ledger account to be debited

  B The name of the ledger account to be credited

  C Narrative

  D The name of the source document from which the information was obtained

. When petty cash is topped up to the imprest amount, the credit entry is made to:

A The petty cash book

B Trade receivables

C Cash at bank account

D Trade payables

. Individual credit customer accounts are kept in which ledger?

A Payables ledger

B Trade receivables

C Receivables ledger

D Nominal ledger

Now go back to the Introduction and ensure that you have achieved the Learning outcomes listed for this chapter.

Answers to Interactive questions

Answer to Interactive question 1

(1) **Purchase of books on credit**			
• Payables increase	CREDIT	payables	(increase in liability)
• Purchases increase	DEBIT	purchases	(increase in expense)
(1) **Purchase of cash register by cheque**			
• Own a cash register	DEBIT	non-current asset	(increase in asset)
• Cash at bank decreases	CREDIT	cash at bank	(decrease in asset)
(3) **Payment received from a credit customer**			
• Receivables decrease	CREDIT	receivables	(decrease in asset)
• Cash at bank account increases	DEBIT	cash at bank	(increase in asset)
(1) **Sell books for cash**			
• Revenue increases	CREDIT	sales	(increase in income)
• Cash at bank account increases	DEBIT	cash at bank	(increase in asset)

Answer to Interactive question 2

			£	£
(a)	DEBIT	Machine account (non-current asset)	8,000	
	CREDIT	Trade payables		8,000
(b)	DEBIT	Purchases account	500	
	CREDIT	Trade payables		500
(c)	DEBIT	Trade receivables	1,200	

			£	£
	CREDIT	Sales		1,200
(d)	DEBIT	Trade payables	300	
	CREDIT	Cash at bank		300
(e)	DEBIT	Cash at bank	180	
	CREDIT	Trade receivables		180
(f)	DEBIT	Wages account	4,000	
	CREDIT	Cash at bank		4,000
(g)	DEBIT	Rent account	700	
	CREDIT	Trade payables		700
(h)	DEBIT	Trade payables	700	
	CREDIT	Cash at bank		700
(i)	DEBIT	Insurance expense	90	
	CREDIT	Cash at bank		90

Answer to Interactive question 3

In this answer we have calculated the balancing figure on the cash at bank account. We shall come back to this in Chapter 5. For now, just make sure that you completed all the necessary steps correctly.

CASH AT BANK ACCOUNT

	£		£
Capital (A)	7,000	Rent (B)	3,500
Bank loan (D)	1,000	Shop fittings (E)	2,000
Sales (F)	10,000	Trade payables (H)	5,000
Trade receivables (I)	2,500	Bank loan interest (J)	100
		Other expenses (K)	1,900
		Drawings (L)	1,500
			14,000
		Balancing figure (the amount of cash left over after payments have been made) – carried down	6,500
	20,500		20,500
Debit balance brought down	6,500		

CAPITAL

	£		£
		Cash at bank (A)	7,000

BANK LOAN

	£		£
		Cash at bank (D)	1,000

PURCHASES

	£		£
Trade payables (C)	5,000		

TRADE PAYABLES

	£		£
Cash at bank (H)	5,000	Purchases (C)	5,000

RENT

	£		£
Cash at bank (B)	3,500		

SHOP FITTINGS

	£		£
Cash at bank (E)	2,000		

SALES

	£		£
		Cash at bank (F)	10,000
		Trade receivables (G)	2,500

TRADE RECEIVABLES

	£		£
Sales (G)	2,500	Cash at bank (I)	2,500

BANK LOAN INTEREST

	£		£
Cash at bank (J)	100		

OTHER EXPENSES

	£		£
Cash at bank (K)	1,900		

DRAWINGS ACCOUNT

	£		£
Cash at bank (L)	1,500		

If you want to make sure that this solution is complete, you should go through the transactions A to L and tick off each of them twice in the ledger accounts, once as a debit and once as a credit. When you have finished, all transactions in the 'T' account should be ticked, with only totals and the balancing figure in the cash at bank account left over.

In fact, there is an easier way to check that the solution to this sort of problem does 'balance' properly, which we will see in Chapter 5.

On asset, capital and liability accounts, the debit or credit balance represents the amount of the asset, capital or liability outstanding at the period end. For example, on the cash at bank account, debits exceed credits by £6,500 and so there is a balance on the credit side carried down to be a debit balance of cash at bank of £6,500. On the capital account, there is a credit balance of £7,000 and so the business owes Ron £7,000.

The balances on the income and expense accounts represent the total of each type of income or expense for the period. For example, sales revenue for the period totals £12,500.

Answer to Interactive question 4

£71.26. This is the total amount of cash that has been used (23.12 + 6.74 + 12.90 + 28.50 = £71.26).

Answer to Interactive question 5

5.1 £200 (£200 × 10 × 10%)

5.2 £90 (£200 × 10 × 90% × 5%)

Answer to Interactive question 6

Seesaw Timber Merchants

Statement of profit or loss for the year ended 31 March 20X6

	£	£
Revenue (150,000 + 34,000 – 8,000)		176,000
Purchases (120,000 – 4,000 – 1,500)		(114,500)
Gross profit		61,500
Expenses		
Distribution costs	32,000	
Administrative expenses	40,000	
		(72,000)
Net loss transferred to the statement of financial position		(10,500)

Answer to Interactive question 7

VAT

	£		£
Balance b/d	15,000	Output tax – (£500,000 × 20%)	100,000
Input tax – Purchases (£120,000 × 20%)	24,000	Cash at bank	12,000
Input tax – Other expenses (£70,000 × 20%)	14,000		
Cash at bank (5,000 + 15,000 + 20,000)	40,000		
Balance c/d	19,000		
	112,000		112,000
		Balance b/d	19,000

Therefore there is a balance **owing to** HMRC of £19,000, which is shown on the statement of financial position as an **other payable**.

Answers to Self-test questions

1 Correct answer(s):

A Increase sales

A credit in a journal entry may increase sales. The other transactions would all be a debit entry.

2 Correct answer(s):

D Is the record of an entity's financial transactions

The nominal ledger is the accounting record in which all financial transactions are recorded.

3 Correct answer(s):

A Left hand side

A credit entry is made in the right hand side.

4 Correct answer(s):

D Decrease capital

Answers A, B and C all describe credit entries.

5 Correct answer(s):

A Decrease an asset

Answers B, C and D all describe debit entries.

6 Correct answer(s):

D Nil

The VAT is recorded in the VAT account when the invoice is first entered in the sales day book, not when the customer pays.

7 Correct answer(s):

A Decrease purchases

A discount received from a supplier will decrease the amount of purchases.

8 Correct answer(s):

D The name of the source document from which the information was obtained

The name of the source document is not required. Items A, B and C are all required in a journal entry, though narrative is often omitted when the journal is routine.

9 Correct answer(s):

C Cash at bank account

The double entry is debit petty cashbook (A), credit cash at bank. Trade receivables and payables (B and D) are unaffected.

10 Correct answer(s):

C Receivables ledger

The receivables ledger contains the individual customer accounts. The nominal ledger (D) contains the trade receivables account (B) which is the total of all the individual customer accounts. The payables ledger contains individual suppliers' accounts.

Appendix

Tax Tables FA2020

Syllabus area: Administration

SUBMISSION DATES

Submission dates for 2020/21 personal self-assessment tax returns

Return filed online	Later of: 31 January 2022 3 months from the date of issue of return
Paper returns	Later of: 31 October 2021 3 months from the date of issue of return

Submission dates for corporation tax returns

Must be filed by 12 months from the end of the period of account.

Submission dates for PAYE information: Real Time Information

Information	**Filing date**
Full Payment Submission (FPS)	On or before the day the employee is paid
P60 (to employees)	31 May following the tax year end
P11D	6 July following the tax year end

PAYMENT DATES

Payment dates for income tax

Payment	**Filing date**
First interim payment (1)	31 January in the tax year
Second interim payment (1)	31 July following the tax year end
Balancing payment	31 January following the tax year end

(1) Interim payments are not required if the tax paid by assessment for the previous year was less than:

£1,000; or

20% of the total tax liability (income tax and Class 4)

Payment dates for capital gains tax

Capital gains tax is payable by 31 January following the tax year end.

Payment dates for corporation tax	
Corporation tax	Nine months and one day after the end of an accounting period
Corporation tax by instalments – large companies	The 14th day of months 7, 10, 13 and 16 counted from the start of a 12-month accounting period
Corporation tax by instalments – very large companies	The 14th day of months 3, 6, 9 and 12 counted from the start of a 12-month accounting period

Payment dates for VAT

	Due date
Electronic payment	7 calendar days after the last day of the month following the end of the return period
Direct debit payment	Collected automatically 3 working days after electronic payment due date

MAIN PENALTY PROVISIONS

PENALTIES FOR INCORRECT RETURNS

The penalties are a percentage of the potential lost revenue

Reason for penalty	Maximum penalty	Minimum penalty with unprompted disclosure	Minimum penalty with prompted disclosure
Careless action	30%	Nil	15%
Deliberate but not concealed action	70%	20%	35%
Deliberate and concealed action	100%	30%	50%

PENALTIES FOR FAILURE TO NOTIFY

Failures to notify chargeability to tax, or liability to register for tax that leads to a loss of tax will result in a penalty. The penalties are a percentage of the potential lost revenue.

Reason for penalty	Maximum penalty	Minimum penalty with unprompted disclosure		Minimum penalty with prompted disclosure	
Deliberate and concealed action	100%		30%		50%
Deliberate but not concealed action	70%		20%		35%
		>12m	<12m	>12m	<12m
Any other case	30%	10%	Nil	20%	10%

COMPANIES: PENALTIES

Offence	Maximum Penalty
Failure to notify chargeability within 12 months of end of accounting period	See above: penalties for failure to notify

Corporation tax: penalties for late filing of a corporation tax return

Offence	Penalty(1)
Late return, up to 3 months late	£100 fixed penalty, or £500 for persistent failure
Return more than 3 months late	£200 fixed penalty, or £1,000 for persistent failure
Return filed more than 18 months but less than 24 months after end of return period	Tax geared penalty of 10% of tax unpaid 18 months after end of return period
Return filed more than 24 months after end of return period	Tax geared penalty of 20% of tax unpaid 18 months after end of return period

(1) The tax geared penalty is charged in addition to the fixed penalty but only one of each type of penalty is charged.

INDIVIDUALS: PENALTIES

Offence	Maximum Penalty
Failure to notify chargeability by 5 October following tax year end	See above: penalties for failure to notify
Late payment of income tax or capital gains tax: (1)	
Unpaid 30 days after payment due date	5% of tax unpaid
Unpaid 6 months after payment due date	Further 5% of tax unpaid
Unpaid 12 months after payment due date	Further 5% of tax unpaid

(1) Late payment penalties do not apply to payments on account.

Income tax and CGT: penalties for late filing of a self-assessment return

Offence	Maximum Penalty
Late return	Immediate £100 fixed penalty
Return more than 3 months late	Daily fixed penalties of up to £10 per day for maximum 90 days
Return more than 6 months but less than 12 months late	Further tax geared penalty of 5% of tax due (minimum £300)
Return 12 months late	Further tax geared penalties apply (minimum £300): 100% if deliberate and concealed(1) 70% if deliberate but not concealed(1) 5% in all other cases

(1) These tax geared penalties are reduced for disclosure as per penalties for incorrect returns.

PAYE: penalties for late returns/ submissions

Number of employees	Monthly penalty
1 to 9	£100
10 to 49	£200
50 to 249	£300
250 or more	£400

If the form is more than three months late, an additional penalty is due of 5% of the tax and NIC that should have been reported.

Additionally, there is a £300 penalty per late P11D return, with an extra £60 per day charged if the delay continues.

PAYE: penalties for late payment

	No of late payments	% of tax unpaid(1)
Penalties for late payment of in-year PAYE depend on the number of defaults in the tax year	1st	nil
	2nd, 3rd & 4th	1%
	5th, 6th & 7th	2%
	8th, 9th & 10th	3%
	11th or more	4%
Where a penalty has been imposed and the tax remains unpaid at 6 months		5%(2)
Where a penalty has been imposed and the tax		5%(2)

remains unpaid at 12 months

(1) The percentage penalty is applied to the total amount that is late in the relevant tax month.

(2) The 6 month and the further 12 month penalties are in addition to the initial penalty for late payment.

VAT: penalties

Offence	Maximum Penalty
Failure to notify liability for registration or change in nature of supplies by person exempted from registration	See above: penalties for failure to notify

VAT: late payment or late filing – default surcharge

Default involving late payment of VAT in the surcharge period[(1)]	Surcharge as a percentage of the VAT outstanding at the due date
First	2%[(2)]
Second	5%[(2)]
Third	10%[(3)]
Fourth	15%[(3)]

(1) Default if late payment of VAT or filing of VAT return and surcharge liability notice issued, but default surcharge only applies on late payment.

(2) No surcharge if it would be less than £400.

(3) Minimum £30 payable.

VAT errors

An error made on a VAT return can be corrected on the next return provided it was not deliberate and does not exceed the greater of:

- £10,000 (net under-declaration minus over-declaration); or
- 1% x net VAT turnover for return period (maximum £50,000)

Alternatively, a 'small' error which is not deliberate may be corrected via the submission of form VAT652. Errors which are not 'small' or errors which are deliberate should be notified to HMRC on form VAT652.

RECORD KEEPING PENALTY

Offence	Maximum Penalty
Failure to keep and retain tax records	£3,000 per tax year / accounting period

INCOME TAX RATES: 2020/21

	Rate	Taxable income band
Main rates		
Basic rate	20%	£1 – £37,500
Higher rate	40%	£37,501 – £150,000
Additional rate	45%	Over £150,000
Savings rates		
Starting rate for savings	0%	£1 - £5,000
Savings income nil rate	0%	First £1,000 or £500
Savings basic rate	20%	Otherwise chargeable at basic rate

	Rate	Taxable income band
Savings higher rate	40%	Otherwise chargeable at higher rate
Savings additional rate	45%	Otherwise chargeable at additional rate
Dividends rates		
Dividend nil rate	0%	First £2,000
Dividend ordinary rate	7.5%	Otherwise chargeable at basic rate
Dividend upper rate	32.5%	Otherwise chargeable at higher rate
Dividend additional rate	38.1%	Otherwise chargeable at additional rate
Default rates		
Default basic rate	20%	
Default higher rate	40%	
Default additional rate	45%	

INCOME TAX RELIEFS	2020/21
Personal allowance	£12,500

CGT RATES

	2020/21
Gains falling within the remaining basic rate band	10%
Gains exceeding the basic rate band	20%

CORPORATION TAX RATES

	FY 2020
Tax rate	19%
Augmented profits limit for corporation tax payment dates – large companies	£1,500,000
Augmented profits limit for corporation tax payment dates – very large companies	£20,000,000

NATIONAL INSURANCE CONTRIBUTIONS

	2020/21		
NIC CLASS 1	Annual	Monthly	Weekly
Primary threshold (PT)	£9,500	£792	£183
Secondary threshold (ST)	£8,788	£732	£169
Upper earnings limit (UEL)	£50,000	£4,167	£962
Apprentice upper secondary threshold (AUST) for under 25s	£50,000	£4,167	£962
Upper secondary threshold (UST) for under 21s	£50,000	£4,167	£962

NIC CLASS 1		Annual	Monthly	Weekly
				2020/21
Employment allowance (per year, per employer)	£4,000			
Class 1 Primary contributions on earnings between PT & UEL	12%			
Class 1 Primary contributions on earnings above UEL	2%			
Class 1 Secondary contributions on earnings above ST where employee aged 21 or over and not an apprentice under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & AUST for apprentices under the age of 25	0%			
Class 1 Secondary contributions on earnings above AUST for apprentices under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & UST for employees under the age of 21	0%			
Class 1 Secondary contributions on earnings above UST for employees under the age of 21	13.8%			
Class 1A contributions	13.8%			

	2020/21
NIC CLASS 2	
Normal rate	£3.05 pw
Small profits threshold	£6,475 pa
NIC CLASS 4	
Annual lower profits limit (LPL)	£9,500
Annual upper profits limit (UPL)	£50,000
Percentage rate between LPL & UPL	9%
Percentage rate above UPL	2%

VAT	
Standard rate of VAT	20%
Reduced rate of VAT	5%

Syllabus Area: Income Tax & NIC

INCOME TAX RATES: 2020/21	**Rate**	**Taxable income band**
Main rates		
Basic rate	20%	£1 – £37,500
Higher rate	40%	£37,501 – £150,000
Additional rate	45%	Over £150,000
Savings rates		

INCOME TAX RATES: 2020/21	Rate	Taxable income band
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Savings income nil rate	0%	First £1,000 or £500
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Dividend upper rate	32.5%	Otherwise chargeable at higher rate
Dividend additional rate	38.1%	Otherwise chargeable at additional rate
Default rates		
Default basic rate	20%	
Default higher rate	40%	
Default additional rate	45%	

INCOME TAX RELIEFS	2020/21
Personal allowance(1)	£12,500
Marriage allowance(2)	£1,250

(1) The personal allowance of any individual with adjusted net income above £100,000 is reduced by £1 for every £2 of adjusted net income above the £100,000 limit.

(2) A spouse or civil partner who is a basic rate taxpayer or who has income of less than the personal allowance is allowed to transfer £1,250 of their personal allowance (ie 10% rounded up to the next £10) to their spouse/civil partner provided the recipient spouse is a basic rate taxpayer.

CAPITAL ALLOWANCES

First year allowances available

100% on new and unused zero emissions goods vehicles

100% on new and unused low emission cars ie electrically propelled or with CO_2 emissions of not more than 50 g/km

100% on electric vehicle charging points

Annual investment allowance

£200,000 pa of expenditure incurred by any business on certain plant and machinery from 1 January 2021.

Writing down allowances

18% pa in the main pool

COMPANY VANS, CARS AND FUEL

Van scale charge

No charge applies if there is insignificant private use

£2,792 if van has zero CO_2 emissions and £3,490 if it has CO_2 emissions

Additional £666 if private fuel provided for the van

Company cars – cash equivalent	
Zero emissions cars	0% of list price

Company cars – cash equivalent

Hybrid cars with emissions 1-50g/km	2% of list price for cars with a battery range of >130 miles
	5% of list price for cars with a battery range of 70-129 miles
	8% of list price for cars with a battery range of 40-69 miles
	12% of list price for cars with a battery range of 30-39 miles
	14% of list price for cars with a battery range of <30 miles
Other cars	15% of list price for cars emitting 51-54g/km
	16% of list price for cars emitting 55-59g/km
	17% of list price for cars emitting 60-64g/km
	18% of list price for cars emitting 65-69g/km
	19% of list price for cars emitting 70-74g/km
	20% of list price for cars emitting 75-79g/km
	Increased by 1% per 5g/km over the 75g/km relevant threshold

Relevant % is reduced by 2% for cars first registered from 6 April 2020

Capped at 37% of list price (ie emissions of 160g/km or more for cars first registered before 6 April 2020 and 170g/km for cars first registered from 6 April 2020)

Diesel cars that meet the Real Driving Emissions Step 2 (RDE2) standard are treated as above, all other diesel cars have a 4% supplement added to the relevant percentage (subject to 37% cap)

Private fuel provided for company car

£24,500 x company car %

PAYE CODES

L	tax code with personal allowance
M	tax code with personal allowance plus claiming marriage allowance
N	tax code with personal allowance less surrendered marriage allowance
S	income taxed at Scottish rate of income tax
C	income taxed at Welsh rate of income tax
K	total allowances are less than total deductions
T	tax code includes other calculations to work the personal allowance, for example it has been reduced because estimated annual income is more than £100,000

NATIONAL INSURANCE CONTRIBUTIONS

	2020/21		
NIC CLASS 1 CONTRIBUTIONS	**Annual**	**Monthly**	**Weekly**
Primary threshold (PT)	£9,500	£792	£183
Secondary threshold (ST)	£8,788	£732	£169
Upper earnings limit (UEL)	£50,000	£4,167	£962

		2020/21		
NIC CLASS 1 CONTRIBUTIONS		**Annual**	**Monthly**	**Weekly**
Apprentice upper secondary threshold (AUST) for under 25s		£50,000	£4,167	£962
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Employment allowance (per year, per employer)	£4,000			
Class 1 Primary contributions on earnings between PT & UEL	12%			
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Class 1 Secondary contributions on earnings above ST where employee aged 21 or over and not an apprentice under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & AUST for apprentices under the age of 25	0%			
Class 1 Secondary contributions on earnings above AUST for apprentices under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & UST for employees under the age of 21	0%			
Class 1 Secondary contributions on earnings above UST for employees under the age of 21	13.8%			
Class 1A contributions	13.8%			

	2020/21
NIC CLASS 2 CONTRIBUTIONS	
Normal rate	£3.05 pw
Small profits threshold	£6,475 pa
NIC CLASS 4 CONTRIBUTIONS	
Annual lower profits limit (LPL)	£9,500
Annual upper profits limit (UPL)	£50,000
Percentage rate between LPL & UPL	9%
Percentage rate above UPL	2%

Syllabus area: Capital Gains

	2020/21
Annual exempt amount	£12,300
Gains falling within the remaining basic rate band	10%
Gains exceeding the basic rate band	20%
Basic rate band	£1 – £37,500

Syllabus area: Corporation tax

	FY 2020
Tax rate	19%
Augmented profits limit for corporation tax payment dates – large companies	£1,500,000
Augmented profits limit for corporation tax payment dates – very large companies	£20,000,000

CAPITAL ALLOWANCES

First year allowances available

100% on new and unused zero emissions goods vehicles

100% on new and unused low emission cars ie electrically propelled or with CO_2 emissions of not more than 50 g/km

100% on electric vehicle charging points

Annual investment allowance

£200,000 pa of expenditure incurred by any business on certain plant and machinery from 1 January 2021.

Writing down allowances

18% pa in the main pool

PAYMENT DATES

Payment dates for corporation tax	
Corporation tax	Nine months and one day after the end of an accounting period
Corporation tax by instalments – large companies	The 14th day of months 7, 10, 13 and 16 counted from the start of a 12-month accounting period
Corporation tax by instalments – very large companies	The 14th day of months 3, 6, 9 and 12 counted from the start of a 12-month accounting period

Syllabus area: Value Added Tax

VAT		
Standard rate		20%
Reduced rate		5%
Annual registration limit	From 1 April 2017	£85,000
Deregistration limit	From 1 April 2017	£83,000
VAT fraction (standard rated)		1/6

Cash accounting	£
Turnover threshold to join scheme	1,350,000
Turnover threshold to leave scheme	1,600,000
Annual accounting	
Turnover threshold to join scheme	1,350,000
Turnover threshold to leave scheme	1,600,000

Flat rate scheme	
Annual taxable turnover limit (excluding VAT) to join scheme	150,000
Annual total income (including VAT) to leave scheme	230,000

Index

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